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Washington, DC 20268-0001

Annual Compliance Report, 2014 : Docket No. ACR2014

INITIAL COMMENTS OF THE GREETING CARD ASSOCIATION

The Greeting Card Association (GCA) files these Initial Comments pursuant to Order No. 2313 (December 31, 2014).

I. INTRODUCTION

The main purpose of these Comments is to assist the Commission in determining whether the one-cent price differential between "Metered" and "Stamped" Single-Piece First-Class Letters complies with the applicable requirements of chapter 36. In GCA's view, the Postal Service has not shown that it does. GCA first raised this issue in Docket R2013-10, the price-cap companion case to the R2013-11 exigency filing.[1] The Commission deferred this issue for annual compliance review disposition.[2] Since compliance reviews cover rates in effect during the Fiscal Year in question, Docket ACR2013 was not an available venue for dispositive review of the differential. GCA therefore presented comments focusing on what, in our view, the Postal Service should have to show in the *next* (2014) review in order to justify the differential.

In these Comments we present largely the same arguments and considerations of fact, sometimes developed in more detail, since in this proceeding the

[1] Comments of the Greeting Card Association (October 17, 2013) ("R2013-10 Comments"). GCA made similar observations in the exigency case, Docket R2013-11, since the differential was a component of it too. Initial Comments of the Greeting Card Association, pp. 25 et seq. We respectfully refer the Commission to these Comments and to those we filed in Docket ACR2013.

[2] Order No. 1890 (November 21, 2013), p. 51.

Commission is finally in a position to decide whether the Metered/Stamped rate differential is lawful when measured by the requirements of ch. 36.

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II. COMPLIANCE IN FY 2014

Because the FY 2014 annual compliance review and the annual CPI-governed rate adjustment are proceeding almost concurrently, in this Docket and Docket R2015-4 respectively, we must distinguish clearly at the outset between two areas where comment is necessary: (i) the compliance issues affecting FY 2014, and (ii) the effect of the change in Single-Piece First-Class Letter rates proposed in the CPI docket. In sections II and III of these Comments, we concentrate on FY 2014 compliance issues. We first explain why the one-cent Metered/Stamped differential effective during FY 2014 failed to comply with all applicable requirements of chapter 36.

A. <u>A just and reasonable schedule of rates and classification</u>

One of the applicable provisions of ch. 36 which sec. 3653(b)(1) makes a criterion for annual compliance reviews is the requirement for establishment and maintenance of a “just and reasonable schedule of rates and classifications[.]” (sec. 3622(b)(8)). We pointed out in previous filings that the Postal Service had failed to show or even argue that this rate differential would comply with it. The differential, while formally turning on the indicia the mailer used, in practice would be almost entirely a detriment to household mailers, and of benefit almost solely to business mailers. The additional cent would be imposed, so far as the regularly reported data available allowed a prediction, on the large class of mailers who as a practical matter could not escape it by metering their mail.[3]

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[3] R2013-10 Comments, pp. 4-6. We recognize that some computer-using households could escape it by substituting PC postage.

B. Uncertain size of target market

1. In Docket R2013-10, the Postal Service explained that the differential was meant particularly to persuade "small and mid-size businesses" to switch to metering their mail. It did not include an estimate of how large this potential market might be.

At least equally important was the lack of an estimate of how many of the 12 billion metered letters shown in the Service's recomputed billing determinants originated with non-meter-using small and mid-size businesses. We observed that postage meters are a long-established technology, actively promoted by their manufacturers to the small-business community, and so we questioned how many potential converts from stamps to metering still exist.

2. The lack of any estimate of potential new metered mail from the target small businesses also meant that no judgment could be made as to how far the differential would serve simply to lower the postage bill for businesses which already metered all the Single-Piece letter mail they sent. This issue bears not only on the question of new Metered volume, but also on the magnitude of operational savings the Postal Service might hope to achieve.

C. Possible ineffectiveness of the differential

GCA argued in R2013-10 that if the small business postage meter market was already well saturated, a possible result of the differential would be to reward (meter-using) mailers for doing just as they had done before the new rate came into being. They would, in other words, be compensated without contributing any new cost savings. We pointed out that this was not a new type of problem; in the early days of worksharing discounts, conservatism in discount design was partly based on a concern that presorting – without a price incentive – was already well-known and in use. Thus not only the potential for new Metered volume, but also the prospect of substantial new processing savings, remained untestable on the record.

D. Rate design

Finally, we suggested that, considered in terms of benefit to the Service, there was no reason to extend the differential to extra ounces; the cost elements affected by choice of indicia seemingly have no relation to weight, since, e.g., a facer-canceller operation should cost the same for any weight cell up to the 3.5 ounce limit.[4]

III. THIS CASE

We have reviewed the still relevant parts of our earlier arguments because they are now properly before the Commission for action on the Metered-Stamped differential. Unfortunately, the Postal Service's filing adds no new argument in justification of the differential. The data filed with the Notice do help in evaluating it; there are new (FY 2014) RPW (by indicia) data, and the First-Class billing determinants now show, for Q2 – Q4, separate data rows as between the Stamped and Metered Letter rates.

A. Compliance with sec. 3622(b)(8)

The problem here is in large measure what it has been all along: is the price discrimination against – effectively – household mailers justifiable, under Objective (b)(8), in terms of benefit to the First-Class mailing community as a

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[4] We understand the opposite view – that the extra ounce charge is *structurally* unrelated to the first-ounce rate but merely adds to it a fixed amount per ounce – but were concentrating in our R2013-10 comments on the total practical effect on the mailer of paying for a heavy piece with stamps. Even if the absence of structural connection between the first-ounce and extra ounce rates is taken as a given, the effect of the current design is still to increase the discriminatory burden on household mailers. As such, it is still relevant to the Objective (b)(8) issue we are raising.

whole, or of operating benefits to the Postal Service? If not, then the rate schedule embodying it is not in compliance with the requirement of a "just and reasonable schedule" of rates and classifications.

We have suggested in the past that if the pool of potential new meter users, and the converted (lower-cost), or even entirely new, volume associated with it, are small in relation to Single-Piece First- Class Letters as a whole, then the differential is not fair to the mailers – largely households – who cannot make use of it.

The new data filed in this Docket offer some assistance. From the RPW (by indicia) data, we extracted volume information for the various categories of Single-Piece letters, excluding those paid with Permit Imprints.[5] For FY 2014 as a whole, the total volume we found for Stamped Letters (as originally explained by the Service, i.e., those paid with stamps or PVI indicia) was:

Stamped	11,444,020,481
PVI	71,737,084
Total Stamped	11,515,757,565

Metered Letters – more properly, "Metered-eligible" since the RPW data are broken down only by type of indicia – (Metered, IBI, and "Other") came to:

Metered	147,521,178
IBI	7.667,142,884
Other	33,890,957
Total Metered	7,848,555,019

We compared these results with those for FY 2013, derived similarly:

[5] We omitted this not insignificant category because it is not easy to imagine a mailer equipped to send Permit-Imprint letters but not also in possession of at least one postage meter, and thus outside the scope of the promotional differential.

Stamped	11,659,240,284
PVI	73,815,717
Total Stamped	11,753,056,001
Metered	252,631,754
IBI	8,259,170,717
Other	43,103,155
Total Metered	8,554,905,426

Of interest here is that the “Metered-eligible” total declined more than the Stamped total: roughly 8.3 percent for the former (which we will call Metered, for simplicity) as against almost 1.9 percent for Stamped. The big (41.6 percent) decline in metered volume (as “metered” apparently is used in the RPW, i.e., in contradistinction to IBI) might be expected with the advance of technology, but IBI volume fell by about 7.2 percent as well. The small Other category lost 21.4 percent. The decline for our total reference group (Single-Piece Letters except for Permit Imprint) rounds to 4.6 percent.

The Metered-Stamped differential was in effect for most of Q2 and all of Q3 and Q4 of FY 2014. The RPW results strongly suggest that it did not result in any detectable increase in the mail eligible to use the differential. There was certainly no indication of wholly new Metered volume, since the relevant categories declined more than Stamped, or than the Single-Piece reference group as a totality. That they lost more volume, as against FY 2013, than did Stamped letters suggests, even if not conclusively, that there was no substantial migration of mail from the Stamped to the Metered indicia types.

We observed in our R2013-10 Comments (p. 6) that

> If we assume that present-day small businesses behave rationally in deciding how to manage their mail, it seems likely that most such businesses which perceive any savings in substituting a meter for stamps will have already done so.

This hypothesis is certainly not rejected by the RPW data. Thus, the potential uselessness of the differential in achieving its goals, which the Postal Service has not negated by any focused presentation, continues to raise serious questions under sec. 3622(b)(8). Charging the household mailer an extra cent so that small and mid-size businesses can be persuaded to switch to metering (which it appears most may already have done) and operating savings will accrue to the Service (which will not happen if Metered Letters do not grow at the expense of Stamped) is unjustifiable if these offsetting benefits are not achieved or are achieved in only a minuscule degree. For all that has been shown to the Commission in the 15 months since the differential was launched, they are not being achieved.

B. <u>Compliance with sec. 3622(b)(1) and (b)(5)</u>

The possibility that household mailers are being burdened to provide some business mailers with a favorable rate which will result in no retained or new volume (ascribable to the lower price and other advantages gained by switching to metering), and no new cost savings for the Postal Service, raises important questions under other mandatory objectives of PAEA. One evident concern is conformity with sec. 3622(b)(1), requiring the new ratemaking system to "maximize incentives to reduce costs and increase efficiency. At least equally important, however, is Objective (b)(5): assurance of adequate revenue for the Postal Service.

1. *Objective (b)(1).* Instituting a rate incentive which significantly fails to elicit cost-reducing behavior by mailers can hardly be thought of as a measure to "maximize incentives to reduce costs[.]" We might read the quoted language to include reduction of costs through increases in volume which spread the fixed portion of product costs over more pieces. But we have in the record no specific information on how the operational benefits the Postal Service foresaw in Docket R2013-10 are split between fixed and variable costs. It is true that by changing

from stamps to a meter, the mailer might substitute a lower level of unit processing cost. But, again, we have no data suggesting that this has happened in the nearly three quarters the differential has been in effect. As noted above, the RPW data are consistent with the supposition that mailer behavior with respect to metering has changed little if at all.

Similarly, the failure of the differential to change mailer behavior would imply that it is not "increas[ing] efficiency" even if we take "efficiency" to mean more than simply reduction in unit processing cost. If the Postal Service is receiving $0.01 less revenue per piece for handling mail indistinguishable in character – including indicia – from what was entered before the incentive began, the result would be no more than a transfer of surplus from producer to consumer. This does not amount to a gain in *overall* efficiency (i.e., with both producer and consumer taken into consideration).

2. *Objective (b)(5).* Perhaps even more clearly, such a result would contravene the "adequate revenue" Objective, sec. 3622(b)(5). If the quantity effect (i.e., percentage change in volume) is smaller than the price effect (i.e., percentage change in price), the Postal Service's revenues will necessarily decline. For the revenue to remain constant, the product would have to be fully price elastic.

Such a level of price elasticity is most improbable, in view of the elasticity results the Postal Service has published. For example, in Docket R2013-11, the exigency proceeding, the Service's *Narrative Explanation of Econometric Demand Equations for Market-Dominant Products* (January 22, 2013), p. 28, shows an own-price elasticity for Single-Piece First-Class Letters and Cards of only 0.090 percent.[6] In the most recent elasticity results, filed on January 20, 2015,

[6] As GCA made clear in that Docket, we do not necessarily accept this value as accurate. Our point here is merely that the Postal Service's own investigations tend to show that a one-cent reduction in Metered Letter revenue is unlikely to be compensated for by new volume.

the corresponding figure is -0.140.[7] Thus neither the Postal Service's econometric work nor the actual behavior of volumes over several quarters of differential rates would suggest that the differential can produce anything but a loss in revenue without offsetting benefits.

Thus the “adequate revenue” Objective, sec. 3622(b)(5) is highly important in this case. While the data available do not allow us to estimate how large the sums given up through an ineffective incentive might be, it is nevertheless intuitively contrary to Objective (b)(5) to continue forgoing them without the prospect of an (at least) offsetting revenue or contribution benefit to the Postal Service.

C. A digression on the FY 2014 Billing Determinants

We have up to now concentrated on the FY 2014 RPW data, comparing them with FY 2013. The Postal Service filing also includes Billing Determinants for FY 2014, and here there are figures which might, at first glance, suggest a more hopeful view of the incentive.

Metered Letters first appear as a line item in the split quarter FY 2014 Q2. The (first-ounce) volume there is 1.469 billion pieces, but in Q3 this rises substantially, to 1.942 billion – up about 32 percent. This level is well maintained in Q4, falling only to 1.931 billion. Does this mean that the incentive has in fact succeeded either in generating new metered volume or in transforming former stamped volume into Metered Letters?

In this context, it is important that the Billing Determinants necessarily depend, in a way the RPW data do not, on what rates are currently tariffed. If a rate category does not exist until partway through Q2, there will be no data for it in Q1 (nor, of course, for any prior year period). Thus the large jump in Metered Vol-

[7] Econometric Demand Equations for Market Dominant Products as of January 2015, p. 12

ume between Q2 and Q3 need not mean (and in our view does not mean) more than that mailers, *including those already using meters or other non-stamp, non-PVI indicia,* have begun to take advantage of the differential.

First, a Q3 increase in Metered of almost half a billion pieces should accompany a corresponding loss on the part of other Single-Piece Letters, if all the increase were assumed, simply for argument's sake, to come from converted mail. Even without that simplifying assumption, the loss should be significant. In fact, the decrease in non-Metered first-ounce volume between Q2 and Q3 was only 105 million pieces, or about three percent. It appears, therefore, that the bulk of the Q3 increase in Metered must have come either (i) from entirely new volume *or (ii) from lagged decisions by meter users to take advantage of the new rate.*[8]

In view of the RPW data, hypothesis (i) – new volume – seems most unlikely. Again, using our restricted set of RPW "metered-eligible" data[9], pro forma Metered volumes would show a *decline* of 11.28 percent, from 2.057 billion to 1.825 billion pieces. That the Billing Determinants show an increase might be due, in part, to Q2 having been a split quarter; before the R2013-10 rates went into effect in late January, there was no such thing as Metered volume, in this sense, for Billing Determinant purposes. This would depress the Q2 Metered volume and so make the Q3 increase seem larger.

[8] Here it would have been extremely helpful to be able to distinguish between existing and new meter users. We have speculated on a possibly more effective promotional incentive applying only to new users of the advantaged categories. These individual mailers should be trackable through meter or PC postage account identifiers established when they begin using their new postage evidencing systems. We suggested how such information might be used (see Docket ACR2013, Initial Comments of the Greeting Card Association, January 31, 2014, p. 2) but relevant data are lacking in this proceeding

[9] For reasons stated in fn. 5, we do not think inclusion of Permit Imprint pieces is appropriate in this context – nor that it would affect our argument.

Similarly, consider the Q2 to Q3 changes as reflected in the RPW data. For Stamped letters there is an *increase* of 0.6 billion pieces, or about 24.6 percent. Pro forma Metered volume, though, declines 11.28 percent, as noted earlier. These numbers are independent of rate structure, and in particular of the implementation of the differential. It seems most improbable that Stamped volume could increase by 0.6 billion pieces in one quarter, while simultaneously undergoing a large diversion into Metered.[10]

To GCA, the most evident, and safest, conclusion is that the upswing in the Billing Determinants Metered volume for FY 2014 Q3 and its maintenance in Q4 are essentially artifacts of the change in rate structure, and not reflections of significant changes in mailer behavior.

IV. THE RATE CHANGES PROPOSED IN DOCKET R2015-4

In the annual CPI-based adjustment filed on January 15, 2015, the Postal Service presented a number of changes in Single-Piece First-Class Letter rates. While these are not before the Commission in this Docket, it would be unrealistic not to recognize the potential effect of one of them: the reduction of the Metered/Stamped Letter differential from one cent to one-half cent.

From the strictly practical standpoint of discriminatory impact on household mailers, the change is of course an improvement. If, as we have suggested in the previous sections of these Comments, the differential has not been effective in saving or increasing Metered volume, or in generating additional processing savings, then some relief for the mailing community not able to use meters is clearly appropriate.

[10] For what light it may shed, we note that the Q2 to Q3 change in Stamped volume for FY 2013 was a decline of a little less than one percent, as reflected in the FY 2013 RPW by Indicia data.

That said, the differential, even cut in half, remains unjustified from the viewpoints of sections 3622(b)(8) (just and reasonable schedule), (b)(1) (maximization of efficiency), and (b)(5) (adequate revenue). While the proposed reduction of the differential is welcome from the strictly practical standpoint, GCA continues to advocate its complete abolition.

IV. CONCLUSIONS

GCA has been discussing the concerns covered in these Comments since Docket R2013-10. We have pointed to the lack of focused justification, including data on how large the target might be, and, especially, how far the target mailers are already doing what the differential aims at persuading them to do. In the previous annual compliance review we suggested areas of inquiry. Unfortunately, except for required periodic reports (which have been instructive), we are informationally little better off now. GCA believes that the Metered-Stamped differential has not been shown to comply with Objective (b)(8) (just and reasonable schedule of rates), Objective (b)(1) (cost reduction and efficiency), or Objective (b)(5) (adequate revenue). The Commission should so find, and take appropriate corrective actions.

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Respectfully submitted,

GREETING CARD ASSOCIATION

David F. Stover
2970 S. Columbus St., No. 1B
Arlington, VA 22206-1450
(703) 998-2568
(703) 998-2987 fax
E-mail: postamp@crosslink.net